

Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-01 INR-07 L-03
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CIEP-01 LAB-04 SIL-01 OMB-01 INT-05 AGRE-00 IO-13
DHA-02 /103 W

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R 231648Z DEC 76
FM AMEMBASSY SANTIAGO
TO SECSTATE WASHDC 2729
INFO AMEMBASSY ASUNCION
AMEMBASSY BRASILIA
AMEMBASSY BUENOS AIRES
AMEMBASSY LA PAZ
AMEMBASSY LIMA
AMEMBASSY MONTEVIDEO
USCINCSO

C O N F I D E N T I A L SECTION 1 OF 2 SANTIAGO 12078

EO 11652: GDS
TAGS: PGOV, ECON, CI
SUBJ: THE CHILEAN ECONOMIC PICTURE AT THE YEAR END

REFS: (A) SANTIAGO 1157, (B) SANTIAGO 8904

1. SUMMARY: ON HIS DESIGNATION AS AMBASSADOR IN WASHINGTON, CHILEAN ECONOMIC MASTERMIND JORGE CAUAS WON ANOTHER VICTORY FOR HIS POLICIES WHEN PRESIDENT PINOCHET BESTOWED HIS MANTLE ON A PROTEGE AND MOVED THE REST OF THE TEAM UP A NOTCH. EVEN BEFORE CAUAS STEPPED DOWN SUCH ECONOMIC DEBATE AS EXISTED IN CHILE WAS AIMED MORE AT NIBBLING AWAY AT HIS ORTHODOX ECONOMICS THAN, AS A YEAR BEFORE, REPLACING IT WITH SOMETHING CLOSER TO TRADITIONAL CHILEAN RELIANCE ON STATE INTERVENTION. ALTHOUGH THE CONOMIC TEAM HAD MADE PROGRESS IN REDUCING INFLATION, BUILDING INTERNATIONAL RESERVES, AND
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BRINGING PUBLIC SECTOR EXPEDITURES UNDER CONTROL, MANY OF CHILE'S BASIC ECONOMIC PROBLEMS REMAIN LITTLE CLOSER TO SOLUTION THAN WHEN THE TEAM TOOK OVER. THE BANKING AND BUSINESS COMMUNITIES, THE LABOR MOVEMENT AND CONSERVATIVE POLITICAL CIRCLES HAVE INTENSIFIED PRESSURES FOR BENDING IF NOT FUNDAMENTALLY MODIFYING POLICY. BUT PRESIDENT PINOCHET'S ENDORSEMENT

OF THE TEAM, COMBINED WITH THE DEPARTURE OF THE AGILE CAUAS, PRESAGES LITTLE GIVE. END SUMMARY.

2. HOW IT WAS: A YEAR AGO, SANTIAGO WAS FILLED WITH SPECULATION THAT THE CHILEAN ECONOMIC TEAM UNDER FINANCE MINISTER JORGE CAUAS WOULD SOON BE THROWN OUT. UNEMPLOYMENT WAS RISING TOWARD A 20 PERCENT RATE, INFLATION WAS VERY HIGH DESPITE CAUAS' EARLIER PROMISES THAT IT WOULD BE UNDER CONTROL, SALES HAD JUST PASSED THEIR LOWEST POINT, AND THE PRICE OF COPPER WAS HANGING AT ABOUT 55 CENTS A POUND. JUNTAMEMBER GENERAL LEIGH'S COMMENTS ABOUT THE SOCIAL COSTS OF THE AUSTERITY PROGRAM BARELY VEILED HIS MISGIVINGS ABOUT SOME OF THE TEAM. RUMORS WERE RIFE THAT OPPOSITION TO CAUAS' POLICIES REACHED INTO OTHER HIGH ECHELONS OF THE MILITARY. AND IDEOLOGICALLY ACCEPTABLE ALTERNATIVES TO CAUAS' "FREE MARKET" POLICIES ABOUNDED. MANY OF THE LOCAL ECONOMIC COGNOSCENTI INDICATED WILLINGNESS TO COLLABORATE IN AN ECONOMIC PROGRAM WHICH LEANED MORE HEAVILY ON GOVERNMENT INTERVENTION AND RESTRAINTS.

3. BY THE END OF FEBRUARY 1976 PRES PINOCHET HAD INCREASED HIS STRENGTH AND MADE CLEAR THAT FINANCE MINISTER CAUAS' FREE MARKET POLICIES WOULD CONTINUE AS THE ORDER OF THE DAY. POLITICALLY MEANINGFUL "ECONOMIC DEBATE" ENDED, THOUGH CRITICISM DID NOT CEASE.

4. CRITICISM CONTINES: CHRISTIAN DEMOCRATS STILL USE THE SLOWNESS OF ECONOMIC PROGRESS TO ATTACK THE GOVERNMENT. CRITICISM FOR SOME ELEMENTS IN THE BUSINESS COMMUNITY AND

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FROM CONSERVATIVE POLITICAL CIRCLES HAS GROWN. ORGANIZED LABOR IS MORE EFFECTIVE IN COMMUNICATING ITS CONCERNS. WORKER FIRINGS COMBINED WITH POOR SALES HAVE LED MANAGEMENT AND LABOR TO VOICE SIMILAR COMPLAINTS ABOUT CONTINUING LOW DEMAND, AND ABOUT FOREIGN COMPETITION BEING STIMULATED BY FALLING TARIFF BARRIERS AND REAL EXCHANGE RATE APPRECIATION. MORE RECENTLY THE GOC SET WHEAT SUPPORT PRICES WELL BELOW EXPECTATIONS (THOUGH ABOUT WORLD PRICES) AND GREATLY AGITATED CHILE'S WHEAT FARMERS AND RECENT WINE IMPORTS FROM ARGENTINA HAVE ANGERED CHILEAN WINE GROWERS. AND WE KNOW THAT SOME MILITARY OFFICERS RAMIN CONCERNED AT THE SOCIAL COSTS OF AUSTERITY, AND THE INFLEXIBILITY OF THE TEAM'S APPROACH.

5. THIS CHRISTMAS EASON THE DEBATE HAS A DIFFERENT QUALITY. A RENEWED SLUMP IN THE COPPER PRICE NOTWITHSTANDING, THE CHILEAN ECONOMIC SITUATION IS SOUNDE THAN A YEAR AGO. FOREIGN EXCHANGE RESERVES ARE UP, AND THE SITUATION WITH RESPECT TO INFLATION AND UNEMPLOYMENT HAS

IMPROVED. PUBLIC SECTOR FINANCES ARE IN MUCH BETTER
SHAPE. MOREOVER, BUSINESSMEN AND CONSERVATIVE POLITICAL

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C O N F I D E N T I A L SECTION 2 OF 2 SANTIAGO 12078

CIRCLES NOT HAPPY WITH THE GOC ECONOMIC POLICIES
RELUCTANTLY PREFER THE PREDICTABILITY OF CURRENT POLICY
TO RADICAL CHANGE. THEY ALSO RECOGNIZE THE LIMITS OF
THEIR POWER AND HESITATE TO INCUR THE DISPLEASURE OF
THE GOVERNMENT BY EXPRESSING OPPOSITION TO VOCIFEROUSLY.
THOSE WITHOUT POLITICAL OR ECONOMIC INFLUENCE -- ORGANIZED
LABOR AS WELL AS THE WIDE GROUP OF THE UN- AND UNDER-EM-
PLOYED -- CONTINUED TO BE UNHAPPY. THEIR DISCONTENT WILL
LIKELY REMAIN MUTED, HOWEVER, SO LONG AS THE STATE'S REPRESSIVE
APPARATUS REMAINS INTACT. MOREOVER, MANY STILL BLAME ALLENDE
FOR THEIR HARDSHIPS.

6. PINOCHET RECONFIRMS SUPPORT: FINALLY, WE UNDERScore
PINOCHET'S CONTINUING STRENGTH AND THE SOLID BACKING HE
GIVES THE ECONOMIC TEAM. HE APPEARS CONVINCED THAT RELATIVELY
FREE MARKET POLICIES OFFER THE ONLY ANSWER TO CHILE'S LONG
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RANGE ECONOMIC AND SOCIAL PROBLEMS. FURTHERMORE THE TEAM PRODUCED RESULTS WHEN HE NEEDED THEM INTERNATIONALLY. BY FORCING CHILE TO LIVE WITHIN ITS MEANS, AT HIGH SOCIAL COSTS, THE TEAM ENSURED THAT CHILE COULD MEET ITS FOREIGN COMMITMENTS. IT THEREBY EARNED THE GRATITUDE OF PINOCHET AND THE MILITARY FOR SPARING THE GOC THE NECESSITY TO CONFRONT THE POSSIBILITY OF HAVING TO TRADE UNPALATABLE POLITICAL CONCESSIONS FOR FOREIGN AID AND DEBT RESCHEDULING.

7. NOW PINOCHET HAS LAID TO REST A SPATE OF RUMORS THAT FOLLOWERS OF CONSERVATIVE EX-PRESIDENT ALLESSANDRI WOULD PICK OFF SOME KEY POSITIONS IN A RESHUFFLING, ONCE CAUAS RESIGNED. WITH THE CURRENT ECONOMIC TEAM EACH MOVING UP A NOTCH AND WITH PINOCHET'S EXPLICIT ENDORSEMENT OF CURRENT POLICIES, SUPPORTERS OF CAUAS' POLICIES (WHICH INCLUDE POWERFUL JOURNALISTIC VOICES SUCH AS "EL MERCURIO" AND "QUE PASA") HAVE CLEARLY WON ANOTHER ROUND.

8. LOOKING AHEAD OVER THE NEXT TWELVE MONTHS AND ASSUMING SLOW WORLDWIDE ECONOMIC RECOVERY WITH COPPER PRICES STABLE AT OR UNDER 60 CENTS PER POUND WE DO NOT SEE ANY INSURMOUNTABLE OBSTACLES TO THE GOC REPAYING ITS FOREIGN DEBTS WITHOUT RESCHEDULING (THE GOC PLANS, REASONABLE, FOR AN AVERAGE PRICE OF 67 CENTS). IT HAS BUILT UP RESERVES OF SOME \$325 MILLION WITH WHICH TO FINANCE AN EXPECTED BOP DEFICIT OF ABOUT \$300 MILLION. SHOULD A WORLD RECESSION FURTHER DEPRESS COPPER PRICES AND COMPEL ANOTHER YEAR OF BELT-TIGHTENING WE THINK THE GOC WOULD BE ABLE TO PLACE BLAME ON EXTERNAL FACTORS AND RIDE OUT THE STORM. THIS IS NOT TO SAY THAT CHILEAN POLICY IS IMPERVIOUS TO EXTERNAL PRESSURES. IT RELIES HEAVILY UPON SHORT AND MID-TERM COMMERCIAL CREDITS, LARGELY FROM US BANKS, AND LONG-TERM CREDITS FROM THE EXPORT-IMPORT BANK, IBRD, AND IDB. PRESSURE FROM THESE SOURCES WOULD REQUIRE THE GOC TO RESTRICT IMPORTS. OVER A LONGER TIME FRAME, IT MIGHT

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